No. 15,238

United States Court of Appeals

For the Ninth Circuit

WESTERN MACHINERY COMPANY,
a corporation,
Appellant,

vs.

NORTHWESTERN IMPROVEMENT CO.,
a corporation,
Appellee.

See back cover for Petition for Rehearing

Appeal from the United States District Court for the Western District of Washington, Northern Division.

Honorable John C. Bowen, Judge.

APPELLANT'S REPLY BRIEF.

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Subject Index

Table of Authorities Cited

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APPELLANT'S REPLY BRIEF.

I.

STATEMENT OF THE CASE.

Unfortunately, several pages of this brief must be devoted to inaccurate and misleading statements made by appellee. Appellee has attempted to minimize the importance of Mr. McMillan's position with appellee by stating that he was a mere "employee" (Appellee's Br. 2). In fact, the trial court found that at all times Mr. McMillan was manager of coal operations of appellee and the only official of that company located in Washington (R. 13).

Appellee claimed that appellant asserted in its brief that appellee "was entitled to be repaid for all expenses of the coal company's mining operation, plus 20%." In fact, at page 3 of its brief appellant stated that the coal company "agreed to reimburse appellee for all costs and expenses incurred by appellee in connection therewith [personnel and equipment supplied by appellee], and in addition to pay to appellee a fixed fee of 20% thereof" (R. 178).

Appellee's statement of the negotiations leading to the signing of the order is entirely inaccurate. Appellee indicates that the reason the order was made in the name of appellee was that a delay would be incurred in investigating the credit of the coal company. The real reason, according to the testimony of Mr. Huckaba, was that credit *would not be extended* to the coal company by appellant, but that the order could be placed by appellee on open account (R. 130). It was not a matter of delay at all but rather that no sale at all could be made to the coal company on open account. This hardly could be viewed as an understanding that the coal company would pay for the machinery as contended by appellee. The pertinent portion of Exhibit 2, which appellee omitted to quote in its brief, states, "This arrangement, of course, makes unnecessary any investigation on your part as to the financial responsibility of the Bellingham Coal Mines Company, which, as you know, was a newly organized corporation." Thus, it is most apparent that appellant was looking solely to appellee for payment.

On page 4 of its brief, appellee stated that appellant sent bills covering each partial shipment of components of the coal washing plant. It failed to point out, however, that these bills were sent to and were in the name of appellee, not the coal company.

Neither were negotiations leading to the issuance of the promissory note solely between Mr. Barshell and Mr. Little, as appellee states. The matter was taken up and discussed with Mr. Ramage and the other directors of the coal company, including Mr. McMillan (R. 202, 210, 212, Exhibit A-9).

Appellee further refers to the note as a "ninety-day promissory note," when in fact the note was payable "on or before ninety days after date" (Exhibit A-6).

Appellant did not, as appellee asserted, intend to indicate that Mr. McMillan's trip to California was to get the extension of time resulting in the promissory note. The trip to California was not until after the promissory note was issued and was referred to by appellant for the sole purpose of showing that after the issuance of the note, as well as before, Mr. McMillan attempted to get indulgences and extensions from appellant.

Finally, appellee makes some point that the record does not adequately support the finding that appellee was a wholly owned subsidiary of the Northern Pacific Railway Co. (But see the letterhead on Exhibits 2, A-12, A-13). No contention was made at the trial that this portion of the exhibits was inaccurate or incorrect. At no time, not even in its brief, has appellee denied

that it is a wholly owned subsidiary of the Northern Pacific Railway Co.

II.

ARGUMENT.

A. PAROL EVIDENCE IS INADMISSIBLE.

In its brief, appellee devotes five pages to the parol evidence issue in this appeal, only nine lines of which deal with the only Washington case directly in point and determinative of this issue. That case, cited in appellant's opening brief, is *Karatofski v. Hampton,* 135 Wash. 139, 237 Pac. 17. Ignoring that case, appellee has cited instead three Washington cases not in point but which discuss in general so-called exceptions to the parol evidence rule. These cases are *Amalgamated Gold Mines Company v. Ridgely,* 100 Wash. 99, 170 Pac. 355, *McGregor v. First Farmers-Merchants Bank & Trust Company,* 180 Wash. 441, 40 P. (2d) 144, and *Buyken v. Ertner,* 33 Wn. (2d) 334, 205 P. (2d) 628. The exceptions referred to in these cases were rejected in the *Karatofski* case and are equally inapplicable here.

In the *Amalgamated* case, the question was *as between the principal and surety,* which was which. Their relationship *as to the creditor,* who was not a party to the action, was not an issue. Furthermore, appellee's statement of the holding of the case (appellee's brief 9) is erroneous and misleading. The parol evidence rule was not discussed; the court merely stated that

the relation of principal and surety may arise by a parol agreement and need not be in writing.

The *McGregor* case did not involve suretyship, but was a suit to determine priorities *between creditors* of an insolvent bank. The court, four Justices dissenting, upheld the introduction of parol evidence to show the conditions under which the bank delivered a cashier's check. The check was in fact delivered as a receipt for money, a finding not inconsistent with the written instrument and leaving unaltered the obligation of the debtor bank to repay the money. As stated in *Schnitzer v. Panhandle Lumber Co.,* 14 Wn. (2d) 438, 128 P. (2d) 501, the court "simply regarded a cashier's check as a receipt for money." Appellee here seeks to change its obligation as principal to that of surety, an alteration contrary to and inconsistent with the written instrument.

The *Buyken* case likewise did not involve suretyship. The extensive quotations from that case printed in appellee's brief (pages 8 and 9) correctly describe the "collateral contract" exception to the parol evidence rule. As stated therein, a "collateral contract" may be proved if it is "separate and distinct from, and independent of, the written instrument, has not been merged in, or superseded by, such instrument, and does not contradict, conflict with, or vary the express or implied provisions thereof or deal with a definite and particular subject matter which the written instrument expressly or impliedly undertakes to cover." In the *Buyken* case, a contract to make the necessary jigs, dyes, patterns, broaches and other tools was rightly

held to be collateral to and independent of the contract to actually manufacture the article itself. In the present case, however, the exception cannot apply. Appellee sought to show an agreement whereby it would be liable in some lesser capacity than that in which it signed the written instrument. Such an agreement is not "separate and distinct from, and independent of, the written instrument"; it does "contradict, conflict with" and "vary" the provisions of the written instrument; and it does "deal with a definite and particular subject matter which the written instrument * * * undertakes to cover."

Appellee also relies on *Howell v. War Finance Corporation,* 71 F. (2d) 237, and *Hoffman v. Habighorst,* 38 Ore. 261, 63 Pac. 610. This court in the *Howell* case permitted parol evidence to determine in what capacity a note secured by a mortgage was signed. Because the note and mortgage related to yet another contract and the maker of the note and mortgage did not have any interest in the property mortgaged, the capacity in which the instruments were signed was not clear and free from ambiguity. Parol evidence to explain was therefore proper. In addition, it was an equity proceeding in which strict application of the parol evidence rule was not required.

The Oregon court in the *Hoffman* case permitted parol evidence to show that the makers of a note were in fact only accommodation makers. In so doing, the Oregon court recognized that other states took the opposite view and would exclude parol evidence for that purpose. Washington is one of those states; in

Karatofski v. Hampton, supra, the Washington court specifically excluded such parol evidence. The parol evidence rule is a matter of substantive law and this court must apply the law of Washington. Accordingly, decisions of other states, even if in point, are not controlling and cannot be considered.

B. APPELLEE IS A PRINCIPAL DEBTOR.

Appellee in its brief refuses to recognize that both it and the coal company can be principal debtors, involving no question of suretyship. Appellee continues to assert that if the coal company was a principal appellee must necessarily be a surety. That this is an erroneous proposition is apparent.

To show it is a surety, appellee points out that Mr. Huckaba knew that the equipment was for the coal company, that the coal company directors had to approve the purchase, and that the original quotation was in the name of the coal company. All of this may be true, but it cannot change the final arrangement consummated. The final Quotation (Ex. 1) was in the name of appellee only and signed by appellee without qualification. Appellee in its brief (p. 12) states that it was agreed that the coal company would pay for the equipment. However, Mr. Huckaba, a disinterested witness at the trial, testified to no such understanding. On the contrary, he testified that the machinery was sold to appellee (R. 31), that credit would not be extended to the coal company (R. 130), and that appellee was well financed and able to place an order on open account (R. 130). Appellant was relying solely on ap-

pellee to pay for the machinery, and this is so even though the coal company might also be liable.

It is significant to note that the record contains no evidence that either Mr. Huckaba or Mr. McMillan ever used the terms "surety" or "principal" during their negotiations. It was always only a question of whom appellant was going to look to for payment. The record is clear that appellee was that person. Under these circumstances, it could hardly be accurate to state that there was an agreement that appellee was a surety, as did appellee on page 8 of its brief.

C. APPELLEE WAS NOT DISCHARGED EVEN IF A SURETY.

1. Appellee, If a Surety, Was a Compensated Surety.

Appellee denies this, maintaining that it "received no consideration whatsoever for obligating itself as surety . . . " (Appellee's Br. 15). It is claimed by appellee that the requirement contained in Ex. 2 that shipment of the machinery be over Northern Pacific, appellee's parent corporation, was merely a request imposing no obligation whatsoever. Appellee even went so far as to state that appellant acknowledged this to be so (Appellee's Br. 12). This assertion is untrue and inaccurate. It was only *before* the contract was entered into that appellant was under no obligation to so ship. The requirement constituted a detriment to appellant which is legal consideration sufficient to constitute appellee a compensated surety.

Further consideration for appellee's promise is found in the enhancement in value of its management

contract with the coal company, as explained in appellant's opening brief. Appellee has not attempted to meet this argument, but merely states that it received no money for becoming obligated for the purchase price of the machinery. It is clear that the acquisition of the machinery increased the productivity of the mine and accordingly made the management contract more valuable, a direct benefit to appellee. It is clear that had there been no management contract, appellee would never have obligated itself to pay the purchase price of the machinery.

Appellee received legal consideration having economic value for its promise to pay the purchase price. It must be considered, therefore, a compensated surety, if not a principal debtor, to which the defense of extension of time is not applicable.

2. There Was No Extension of Time.

It is appellant's position that no time for payment was fixed until the execution and delivery of the promissory note. Appellee maintains that the order (Ex. 1) indicates that payments were to be made at the times of shipment, that the billings for partial shipments indicated that the times for payment were the 10th of the month following, and that such billings were reflected on an open account after each shipment. If each shipment were a separate piece of machinery and could be used independently of each other's shipment, appellee's argument would not be without force. However, in this case each shipment was of a part only of a machine which was to be assembled and put in opera-

tion by appellant at the coal mine site. Under these circumstances the purchaser of the machine could not be required to pay the purchase price until the whole machine was furnished, installed, ready for operation and accepted as such. It was not until after the final partial shipment was made and about one week before installation was completed that any attention was directed to the methods and time of payment. Various means of payment and security therefor were discussed. On the day after completion of installation a payment date was set and the promissory note issued. It was not until this occasion that a date for payment of the balance of the price for the completed product was set. Under these circumstances, it cannot be said that there was any extension in fact.

3. There Was No Binding Agreement Extending the Time for Payment.

Again appellee has almost completely ignored the leading Washington case directly in point on a vital issue, *Van de Ven v. Overlook Mining Co.,* 146 Wash. 332, 262 Pac. 981. In addition, it has incorrectly stated the facts of that case, as follows:

> "In that case the payee merely wrote on the back of the promissory note that he would *permit* payment to be made on or before six months from the date of his notation." (Page 19)

In fact, the endorsement read:

> "June 28, 1917, I hereby grant the extension of time of payment of the within note on or before six months from June 28, 1917, at 8%."

This was by no means a "mere forbearance" as appellee would have the court believe (Appellee's brief 19), but was an agreement to extend the time of payment. That agreement the court found to be unsupported by a consideration and lacking in mutuality because the debtor at any time could pay the note without any obligation for interest for the full period of the extension. In other words, by paying the note the debtor would be doing only that which he was bound to do before the extension was given and nothing more.

The coal company's note, too, provided for payment on or before a certain date and was therefore practically identical, except for the attorneys' fee provision. This provision did not cure the lack of consideration, as it also was infected by the fatal lack of mutuality. The debtor at any time could pay the note without any obligation for attorneys' fees. At no time before or after payment during the period could the creditor require the debtor to pay attorneys' fees. Likewise, it could not require the debtor to pay interest for the full ninety days if the principal were paid during the period. The text and legal encyclopedia writers also agree that mutuality is necessary to create a binding extension of time (see Appellant's opening brief, page 38).

Appellee has cited *Yakima Hardware Co. v. Strickler,* 164 Wash. 155, 2 P. (2d) 90, apparently contending that it overrules the *Van de Ven* case. This is a rather odd proposition in that the *Yakima* case is clearly distinguishable on its facts. Further, it appears that the court in that case did not consider its prior

decision in the *Van de Ven* case, which indicates that the court did not consider the two cases similar. Also, since decisions are not overruled by implication, the *Yakima* case, even if actually in conflict in principle as appellee contends, must be strictly limited to its peculiar facts.

The extension in the *Yakima* case was between the owner of an insolvent business and his many creditors. It provided for payment of "at least 5%" of the debt "on or before the 30th of each month" with interest. Had the agreement contained no more, the case would have been similar to the *Van de Ven* case. However, it contained the following additional provisions which constituted independent consideration for the extension:

1. The insolvent business was to be continued as a going concern for the creditors' benefit;

2. The debtor was required to purchase all merchandise from the participating creditors;

3. No other creditors were to be paid without the consent of the participating creditors;

4. The participating creditors were given direct control over the management of the business;

5. The creditors were given an interest in the assets of the business;

6. The participating creditors were to receive interest in excess of that to which they were otherwise entitled.

These were independent and direct benefits to the creditors which could have been enforced by the credi-

tors at any time regardless of whether the payments called for by the agreement were regularly made by the debtor. Accordingly, there most certainly was no lack of mutuality in that agreement. As proof of this fact, it should be noted that the court limited its discussion of the words "on or before" to whether they made the due date and therefore the agreement too *indefinite* to be enforced. No reference was made to mutuality. Clearly the *Yakima* case is not in conflict with the *Van de Ven* case and is not in point here.

Appellee has cited three cases to support its proposi- that an agreement to extend time need not be supported by a new consideration. None of the cited cases so hold. In *Seattle Association of Credit Men v. American Alliance Aluminum Smelting Corporation,* 42 Wn. (2d) 636, 257 P. (2d) 637, the creditor received a mortgage to secure payment of the note which constituted the extension of time; the mortgage was clearly consideration for the extension of time. In *Katz v. Judd,* 108 Wash. 557, 185 Pac. 613, and *Shrive v. Crabtree,* 149 Wash. 500, 271 Pac. 329, there was new consideration for the extension consisting of the debtor's obligation to pay interest for the full period of the extension even if the principal were sooner paid. These cases do not support appellees proposition and are not in point here. See *Strong v. Sunset Copper Co.,* 9 Wash. (2d) 214, 114 P. (2d) 526.

Mohn v. Mohn, 181 Iowa 119, 164 N. W. 341, cited by appellee is not the law in Washington. Apparently appellee failed to read carefully the *Van de Ven* case, which is a Washington case holding to the contrary.

The authorities cited by appellee and the facts of this case do not support the trial court's finding that there was a binding agreement extending the time for payment.

4. Appellee Consented to the Extension of Time and Is Estopped to Deny Its Consent.

Appellee, realizing how intimately Mr. McMillan was involved with the circumstances resulting in the delivery of the promissory note, has attempted in its brief to portray Mr. McMillan as a casual passerby ignorant of and oblivious to the economic crisis with which the coal company was enveloped. In fact, appellee even suggests to the court that Mr. McMillan, a vice president director and the operating manager of the coal company, did not discuss the note at all before it was given (Appellee's Br. 29). This suggestion is most reckless and contrary to the record. Mr. Little, a director and secretary of the coal company, testified that Mr. McMillan was present at meetings of the board of directors at which the issuance, execution and delivery of the note was discussed (R. 207). He was also at meetings prior to the issuance of the note at which Mr. Little was instructed to request indulgences and extensions from the various creditors of the coal company, including appellant (R. 208). In fact, these meetings were arranged so that Mr. McMillan could be present because, as Mr. Little stated, "he was an important employee of the company." (R. 208). In addition, it is clear that Mr. McMillan approved the

note prior to its transmittal to appellant (R. 210-212, Ex. 8, Ex. A-9).

Appellee in its brief (p. 25) maintains that the record does not support appellant's assertion that Mr. McMillan consented to the issuance of the note. The above citations thoroughly support that assertion. Also, the facts which so closely identify Mr. McMillan with the entire transaction, beginning with negotiations for the purchase of the machinery and ending with the final attempt to pay therefor, are succinctly and accurately set forth at pages 42-43 of appellant's brief.

Appellee has cited three Washington cases for the proposition that consent of the surety to the extension of time and not mere knowledge thereof is essential to preclude discharge of a surety. Appellee relies principally on *Thompson v. Metropolitan Building Company,* 95 Wash. 546, 164 Pac. 222. However, in the more recent *Yakima Hardware Company* case, supra, relied upon so strenuously by appellee in another part of its brief, the Washington court stated:

> "There can be no doubt, upon the evidence, that the contract of May 2, 1927, was entered into without the *knowledge* or assent of Mrs. Strickler."

It is by no means clear from the Washington decisions cited by appellee that in Washington *knowledge* by the surety of the intended extension of time is not sufficient to preclude the surety's discharge, especially where the same individual represents both the principal and surety. In the *Thompson* case the principal

and surety were not represented by the same individual nor did the surety in any way participate in effecting the extension, thus the court's comment that mere knowledge was insufficient to preclude the surety's discharge. That case, however, cannot be considered authority as the court's comment was merely dicta, the case being decided on another ground.

To distinguish the cases cited by appellant, appellee has summarily established three supposedly exclusive fact situations in which an extension of time would not discharge the surety. Appellee then equally summarily fits some of the cases cited by appellant into one of these categories and, of course, excludes the case now before the court. Strangely, however, three cases cited by appellant which are directly in point appellee has answered by completely ignoring. These are *Thomasson v. Walker,* 168 Va. 247, 190 S. E. 309, *Austin v. Gibson* (1878) 28 U.C.C.P. 554, and *Foster v. First National Bank & Trust Co. of Tulsa,* 179 Okla. 496, 66 Pac. (2d) 79. Appellee's failure to make any real attempt to distinguish the authorities cited by appellant can be for only one reason, i.e., it cannot honestly do so.

Appellee has meticulously avoided any reference to the fact that Mr. McMillan was at all times the primary representative of both the coal company and appellee; he was figuratively but one individual wearing two hats. It was his duty to inform the people with whom he dealt which hat he was wearing or, in other words, to advise on whose behalf he was acting.

It does not appear from the record that Mr. McMillan ever informed appellant that he was not acting for appellee as well as for the coal company at any time during the discussions relating to forbearances and extensions of time. In fact, Mr. McMillan even failed to inform the other officers of the coal company, until long after the note was due and the coal company was insolvent, that he had placed the order for the machinery in the name of the appellee only (R. 206-7). Because of his dual role and his failure to inform appellant on whose behalf he was acting, appellant was entitled to assume that he was acting in the capacities for which he had authority to act. He was both the representative of the coal company and the sole representative of appellee with whom the parties transacted business. Appellee must therefore be estopped to deny its assent, through Mr. McMillan, to the alleged extension.

III.

CONCLUSION.

Parol evidence was inadmissible to show that appellee signed the order for the machinery otherwise than as a principal debtor. Appellee has been unable to show that the rule of the *Karatofski* case is not applicable and controlling here. Accordingly, the trial court erred in admitting such evidence.

Appellee was a principal debtor even though the coal company may likewise have been a principal debtor.

When the order was signed appellant treated appellee as such and looked solely to the ability of the latter to pay.

Even if only a surety, appellee was nevertheless not discharged:

1. Appellant was not aware of the surety relationship.

2. Because appellee received legal consideration, it was bound and should be treated as a compensated surety.

3. There was no extension of time in fact; the note merely set a date for payment to be made, no other date having previously been fixed.

4. Because it provided for payment "on or before" a certain date, the alleged extension agreement lacked mutuality, there being no independent consideration to support it.

5. Because of Mr. McMillan's intimate connection with the affairs of both the coal company and appellee, and his repeated requests from appellant for indulgences and forebearances both prior and subsequent to issuance of the note, appellee, through Mr. McMillan, must be deemed to have consented to the alleged extension. In view of the dual capacity in which Mr. McMillan was acting, it was his duty to make known to all parties the capacities in which he was acting. Having failed to do so, appellee should be estopped to deny its assent to such extension.

Appellee has failed to sustain the burden of proving that it was a surety and that there was a valid and

binding agreement extending the time of payment without its consent. Having failed to sustain its burden, its affirmative defenses should have been denied and judgment awarded to appellant.

Dated, San Francisco, California,
June 17, 1957.

Respectfully submitted,
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